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SUBJECT: SALVADORAN NONMAQUILA EXPORTS BOOM UNDER CAFTA-DR

REF: A. SAN SALVADOR 2526, B. SAN SALVADOR 2513, C. SAN SALVADOR 2475, D. SAN SALVADOR 1719

Summary

¶1. Central Bank data show that nonmaquila exports were 64 percent higher during the first six months of CAFTA-DR than they were March to August 2005, increasing from $123 million to $202 million. Much of that increase reflects Salvadoran exports of ethyl alcohol, thanks to liberal CAFTA-DR rules of origin, but exports of some agricultural and processed foods as well as light manufactures also increased. Maquila exports have largely rebounded from difficulties related to CAFTA-DR's staggered entry into force, but their impact resulted in an overall fall in exports (including maquila) of 6 percent for the period. End summary.

Maquila Exports Suffer, Overall Exports Decline

¶2. During the first six months of CAFTA-DR, Central Bank data show Salvadoran exports to the United States (including maquila, that is, apparel manufactured for export in a free trade zone using mostly imported components) fell by 6 percent compared to the same March 1 - August 31 period in 2005, from $1.02 billion to $959 million. A 16 percent decline in maquila exports, from $898 million to $757 million, accounted for nearly all the decrease. Maquila exports suffered because El Salvador pushed for CAFTA-DR entry into force months ahead of its Central American peers and for several months could no longer source raw materials for maquilas from neighboring countries as it had under the Caribbean Basin Initiative.

¶3. Textile and apparel exports produced by so-called "national" firms, which sell locally in addition to exporting and typically use more local inputs, grew by 33 percent under CAFTA-DR, up to $16.2 million from $12.1 million in March to August 2005. Exports of towels, which previously faced a 9.1 percent tariff, increased 48 percent from $3 million to $4.5 million. U.S. Department of Commerce monthly data suggest Salvadoran apparel exports (including both maquila and national firms) have rebounded in recent months, and for July and August 2006 they exceeded 2005 levels for those months. Ref. C described the textile and apparel sector in more detail.

Nonmaquila Exports Grow 64 Percent

¶4. Central Bank data show a much more positive picture of Salvadoran exports under CAFTA-DR when maquilas are excluded. Nonmaquila exports were 64 percent higher during the first six months of CAFTA-DR than they were March to August 2005, increasing from $123 million to $202 million. Much of the increase in exports can be linked directly to skyrocketing ethanol exports, which increased from $5.9 to $85.4 million, made possible by liberal

CAFTA-DR rules of origin. Ref. B described current Salvadoran ethyl alcohol production capacity and plans for expansion.

¶5. During the first six months of CAFTA-DR, Salvadoran data show sugar exports fell by $16 million, reflecting the expiration of a supplemental quota that El Salvador had filled in the period March to August 2005. Other sectors took up the slack for sugar, in some cases taking direct advantage of CAFTA benefits. Dairy exports nearly quadrupled, increasing from $102,000 (March - August 2005) to $378,000 (March - August 2006). Cheese, which faced a range of tariffs before CAFTA-DR (and still faces a tariff-rate quota for some varieties), accounted for most of that growth. Dairy exports are expected to continue to grow as local producers target Salvadorans living in the United States.

¶6. Other products that target Salvadorans in the United States also show potential, based on exports during the first six months under CAFTA-DR. Cookies, pastries, and other snack foods--although in many cases not subject to tariffs before CAFTA-DR, showed 37 percent growth, increasing from about $2.2 million before CAFTA-DR to $3 million after the agreement entered into force. Exports of tropical fruit juice blends--once subject to a 7.4 cents/liter tariff--increased 78 percent from $877,000 to $1.6 million. Exports of beans, subject to a nominal tariff before CAFTA, increased from $2.1 million to $2.7 million.

¶7. Light manufacturing showed positive growth as well under CAFTA-DR, although nearly all these exports already entered the United States duty free before the trade agreement entered into force. Exports of tools and implements tripled, increasing from $676,000 to $2.2 million, while exports of toys and games--some of which did face a tariff before CAFTA-DR--increased from $182,000 to $673,000, more than tripling.

Salvadoran Imports of U.S. Goods up 10 Percent
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¶8. U.S. exports to El Salvador increased nearly 10 percent during the first six months of CAFTA-DR, from $1.3 billion to $1.5 billion, despite a 14 percent fall in exports of inputs for El Salvador's maquilas (from $559 million to $482 million). U.S. export growth was balanced among most sectors. For sensitive agricultural goods, U.S. producers quickly took advantage of expanded access, though they were still limited by tariff-rate quotas. For example, U.S. pork and beef exports grew overall from $359,000 to $1.7 million. Salvadoran rice imports grew only 4 percent over the period, $11.7 million to $12.1 million, while sensitive white-corn imports grew only 2 percent from $6.5 million to $6.7 million. Less sensitive yellow-corn imports increased from $25.7 to $32.4, a 26 percent jump.

Comment

¶9. Given the size of the Salvadoran economy, the timing of individual orders can have a noticeable impact on the data. Still, the early data suggest that Salvadoran exports are already benefiting from CAFTA-DR market access. When viewed with firm-level information provided in Ref. D, the case is even stronger--juice exports are growing thanks to Del Monte's focus on the U.S. market, local firm Quesos Petacones is pushing cheese exports, and towel manufacturer Hilasal is receiving more orders for U.S. export. However, new investment--either greenfield or to expand existing capacity--will be required to take advantage of other CAFTA-DR opportunities. That could take time, because both domestic and foreign investment have in recent years been among the lowest in the region, attributable in part to the worsening security situation here. See Ref. D. End comment.

Barclay